Commonwealth of Massachusetts
Department of Telecommunications and Energy

Petition of Massachusetts Electric Company,	)	D.T.E. 02-79
Nantucket Electric Company, and	)	D.T.E. 03-124
New England Power Company	)	D.T.E. 03-126
For Approval of an Offer of Settlement	)	

Comments of
Constellation NewEnergy, Inc. and
Constellation Energy Commodities Group, Inc.

I. INTRODUCTION

Constellation NewEnergy, Inc. ("CNE") and Constellation Energy Commodities Group, Inc. ("CECG") (collectively, "Constellation") are pleased to submit the following comments to the Department of Telecommunications and Energy (the "Department") regarding the Offer of Settlement (the "Settlement") submitted by Massachusetts Electric Company, Nantucket Electric Company, and New England Power Company (collectively the "Company"). The settlement proposes to resolve a number of issues, including the timing and mechanism for recovery of over $66 million in deferred standard offer supply costs that will remain at the end of the standard offer period.

CNE is the leading competitive supplier of electricity in the United States and is a licensed electric retail supplier in 14 states, including Massachusetts, and two Canadian provinces. CNE currently provides over 10,000 megawatts ("MW") of electric supply directly to businesses throughout the country for their own use. CECG is a wholesale supplier of electric power to many of New England's electric utilities in connection with either their standard offer or default service obligations. CNE and CECG are subsidiaries of

Constellation Energy Group, Inc., a Fortune 300 company headquartered in Baltimore, Maryland which also owns Baltimore Gas and Electric Company, a regulated utility.

II. SUMMARY

Constellation urges the Department to reject the Settlement.

The Settlement would take over $66 million of standard offer Service ***supply costs***, ***defer them until 2010***, and then collect them, with interest, from all customers through ***distribution charges***.[1] **(**Settlement Agreement §2(c)). This provision of the Settlement should be rejected, for many reasons.

First, it would violate five years of Department precedent requiring that standard offer and default service prices reflect the full cost of the service. See, e.g., Fitchburg Gas and Electric Light Company, D.T.E. 97-115/98-120 (1999); Western Massachusetts Electric Company, D.T.E. 97-120, (1999); Standard Offer Service Fuel Adjustments, D.T.E. 00-66, 00-67, 00-70, (2000); Pricing and Procurement of Default Service, D.T.E. 99-60-A (2000); Provision of Default Service, D.T.E. 02-40-B (2003).

Second, it would undermine the competitive electric market by subsidizing standard offer prices through distribution rates.

Third, it would violate principles of cost causation and equity by recovering past standard offer costs from future customers more than five years hence.

Finally, the proposed cost deferral is not required by either the Massachusetts Electric – Eastern Utilities merger settlement agreement, approved by the Department in

[1] The Settlement Agreement clearly states that the costs would be deferred to 2010, but does not explicitly state where in rates they would be recovered. However, given that the balance of the agreement deals with distribution rates, and that the January 2010 date for the commencement of cost recovery coincides with the expiration of the ***distribution rate*** index period established by the Massachusetts Electric – Eastern Utilities merger settlement agreement (Settlement, Attachment 1), the clear implication is that the costs would be recovered through distribution rates.

Docket D.T.E. 99-47, or the Massachusetts Electric Restructuring Settlement Agreement, approved by the Department in Docket D.P.U./D.T.E. 96-25.

The Company proposes the Settlement for a number of reasons including "to smooth the total impact associated with customers moving from standard offer service to default service." (Cover Letter p. 2) Due to the Company's inability to recover these costs over the past three years, it may now be true that it is not possible to recover the costs over the final two months of standard offer service without creating an unacceptable rate impact. While there is no question that the Company should be allowed to recover these costs, there are other ways of doing so that would be much more desirable than the approach in the Settlement.

Constellation's recommendation is as follows. Given that standard offer customers will convert to default service in just two-and-one-half months, the costs should be recovered through a surcharge on default service prices. The surcharge should begin on May 1, 2005[2] and run for a 12-month period. This approach would keep these supply costs in supply prices, would avoid lengthy deferrals and would coincide well with the ongoing default service procurement process. It would also ensure that the costs are recovered primarily from the customers on whose behalf they were incurred: today's standard offer customers. The rate impact of this approach would be approximately $0.0042/kWh.[3, 4]

[2] The May 1 start date is necessary because Massachusetts Electric will be receiving bids on Tuesday, December 14, for default service supply for February through April. Delaying the surcharge until May is essential to preserve the integrity of those bids.

[3] The estimated rate impact was calculated by spreading the $66,359,359 deferral over total kWh deliveries to Massachusetts Electric and Nantucket Electric standard offer and default service customers during the most recent 12-month period reported by the Division of Energy Resources. (DOER Electric Customer Migration Data, November 2003 – October 2004). The estimate is approximate. No adjustments were made for future load growth (which would decrease the per kWh impact) or customer migration (which would increase it).

III. THE COSTS THAT THE SETTLEMENT PROPOSES TO DEFER ARE SUPPLY AND SUPPLY-RELATED COSTS.

There is no question that the costs at issue are supply and supply-related costs.

The costs are listed in Attachment 3 to the Settlement, an attachment labeled "Summary of ***Supply Related Costs*** Listed in Possible Settlement" (emphasis added). The costs listed in Attachment 3 are as follows:

GIS Costs	$533,363
Congestion Costs	$5,973,043
Post-SMD ISO Costs	$863,997
RPS Costs	$15,242,411
Estimated 2003 SO Deferral Not Recovered by end of 2004	$7,254,994
Estimated SO Deferral at February 28, 2005	$36,491,551
TOTAL – Estimated Balance in SO Deferral Account at February 28, 2005	$66,359,359

The Department has clearly ruled that these are supply and supply-related costs. See, e.g., Provision of Default Service, D.T.E. 02-40-B (2003) (congestion costs); Provision of Default Service, D.T.E. 02-40-C at 17 (2003) (RPS costs).

IV. THE PROPOSAL TO DEFER RECOVERY OF STANDARD OFFER COSTS FOR FIVE YEARS AND THEN TO RECOVER THOSE COSTS THROUGH DISTRIBUTION RATES WOULD VIOLATE ESTABLISHED DEPARTMENT PRECEDENT REGARDING RECOVERY OF SUPPLY COSTS, WOULD UNDERMINE THE COMPETITIVE MARKET, AND WOULD VIOLATE PRINCIPLES OF COST CAUSATION AND EQUITY.

A. The Proposal would Violate Department Precedent.

Since 1999, the Department has established a clear line of precedent requiring that "prices for generation -- the only competitive portion of customers' electricity service -- reflect the *full* costs of the service, in order to promote competition." Standard Offer Service Fuel Adjustments, D.T.E. 00-66, 00-67, 00-70 (December 4, 2000), *citing*

[4] If the Department believes that the rate impact would be too great, the Department could defer costs other than supply costs, e.g., stranded cost charges, thereby providing for rate stability while not violating its

Fitchburg Gas and Electric Light Company, D.T.E. 97-115/98-120, at 30 (1999); Western Massachusetts Electric Company, D.T.E. 97-120, at 190 (1999).

In Fitchburg Gas and Electric Company, D.T.E. 97-115/98-120 (1999) the Department directed the company "to implement a standard offer retail price that is equal to the price that Fitchburg is paying suppliers for standard offer service," noting that this was necessary "[t]o meet the [Restructuring] Act's goals of providing an expedient and orderly transition from regulation to competition." Id at 30.

The Department recognized that it had previously approved restructuring plans in which retail standard offer prices did not reflect wholesale costs. Id at 20 - 21, *citing* Boston Edison Company, D.P.U./D.T.E. 96-23 (1998); Eastern Edison Company, D.P.U./D.T.E. 96-24 (1997); Massachusetts Electric Company, D.P.U./D.T.E. 96-25-B (1997); and Cambridge Electric Light Company/Commonwealth Electric Company/Canal Electric Company, D.P.U./D.T.E. 97-111 (1998).

However, the Department went on to explain that its earlier decisions were:

> issued prior to the retail access date of March 1, 1998. Based on our observation of market activity in Massachusetts and other jurisdictions during the past year, the Department now believes that the transition to a competitive market may be slowed unnecessarily by the divergence of retail and wholesale prices. A three-year delay before convergence of the retail standard offer generation price with standard offer supply costs undermines our goal of promoting the development of competitive generation markets in an expeditious manner. Where there is an opportunity for the Department to ensure that these prices coincide, the Legislature's direction to us to advance competitive generation markets requires us to act to achieve that goal.

Id at 28. The Department further noted that:

> While the deferral of a retail/wholesale price differential can be appropriate for the short-term transition period (through the end of 1998 in this case), ***the negative impact of such a differential on the development of competition becomes a more significant factor as the market develops***.

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precedent that standard offer and default services prices must reflect the full cost of providing the service.

Id at 29 – 30 (emphasis added).

In Western Massachusetts Electric Company, D.T.E. 97-120 (1999), the Department followed the precedent from Fitchburg, and ordered the company to set its standard offer retail price at the company's wholesale supply price. The Department recognized that there might have to be some standard offer deferrals, but directed that ***"any deferral associated with under-recovery of standard offer costs would have to be recovered as quickly as possible."*** Id at 191 (emphasis added).

The Department continued to develop this line of precedent in its courageous decision in December 2000 regarding the standard offer fuel service adjustment ("SOSFA"). Standard Offer Service Fuel Adjustments, D.T.E. 00-66, 00-67, 00-70 (December 4, 2000). Faced with skyrocketing fuel prices, steeply rising standard offer deferrals, and calls to delay recovery, the Department directed the companies to implement the SOSFA "immediately." The Department explained its reasoning as follows:

> [C]ontinuing to price standard offer service significantly below costs artificially impedes the development of a truly robust competitive market and the ability of competitive suppliers to develop products at prices that would attract customers. Standard offer service is a transition mechanism that is intended to be phased out by March 2005. Artificially suppressing standard offer service's price would preclude effective competition for customers by competitive suppliers. Stunting the growth of the competitive suppliers' share of the power market patently would subvert, and could well defeat, the purposes of the Restructuring Act. If we did not allow this market to develop, the promise of electric restructuring would remain unrealized. Consumers would be ill-served in the long run. The Department must make every effort to ensure that customer choice is a valid option for all as soon as possible.[5]

[5] In Standard Offer Service Fuel Adjustments, the Department cited the assertion of one of the parties that standard offer costs that are not recovered from standard offer customers "now" would be recovered from all customers in the future, regardless of whether they received standard offer service. However, the Department did not provide a further reference for this assertion. The comments cited by the Department

Id.

The Department continued to develop this precedent in a series of orders regarding Default Service. In Pricing and Procurement of Default Service, D.T.E. 99-60-A (2000), the Department rejected suggestions that default service prices should remain tied to below-market standard offer prices. Instead, the Department moved to market-based default service pricing, noting that:

> an important goal in electric restructuring is the development of a competitive marketplace. It is essential to the development of a robust competitive market to have prices set at levels that provide customers with appropriate price signals regarding the costs associated with providing the service, as established by the competitive market. Default service prices that do not represent the actual cost of providing the service would inhibit the development of a competitive generation market and would thus be detrimental to all electricity consumers.

Id at 7.

In Pricing and Procurement of Default Service, 99-60-C (2000) the Department considered default service reconciliations. Because the six-month, fixed default service prices are based in part on estimates of load for the six-month period, default service revenues do not always match default service costs, creating a need for periodic reconciliations. The Department ruled that these costs should be reconciled annually; it did not approve a lengthy deferral.[6]

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actually raised a different concern: that over time large numbers of standard offer customers would migrate to competitive service, leaving a small base of remaining standard offer customers from whom the deferrals would be recovered. *Initial Comments of the Associated Industries of Massachusetts*, D.T.E. 00-66, 00-67, 00-70. As is discussed below, and as the Department suggested in its order, recovering Standard Offer costs from all customers would be inequitable. It would also be unnecessary given the large base of Standard Offer customers that will migrate to Default Service.

[6] The Department also ruled that over- or under-recoveries should be recovered through distribution rates rather than default service prices. Significantly, however, the rationale for that decision does not apply to the proposed standard offer deferrals. In Pricing and Procurement of Default Service, the Department was concerned that recovering the default service reconciliations through default service charges would cause "large swings in the default service price" from month to month. Id at 13. As a result, the Department determined that it was just "not practical" to recover the costs through default service charges. Id. That concern does not apply here because the amount of the standard offer deferrals will be fixed – it will not

In Provision of Default Service, D.T.E. 02-40-B (2003), the Department expanded its directive that standard offer and default service prices should include all supply costs, directing that default service prices should reflect not only payments to wholesale suppliers, but also a set of other supply-related costs, including procurement costs, unrecovered bad debt, the costs of complying with default service regulatory requirements, and the costs of RPS compliance.

The Department explained its reasoning as follows:

> [T]he slow rate at which a competitive market has developed for the residential and small C&I customer classes indicates the importance of ensuring that default service prices include the full costs incurred in providing the service. Default service may serve as a barrier to competition as long as competitive suppliers must recover all of their costs through the prices they charge customers, while distribution companies are able to recover some of their default service-related costs through their distribution base rates. Therefore, we find that it is appropriate to include the costs that distribution companies incur in providing default service in their default service prices.

Id at 15.

B. The Settlement would Undermine the Competitive Market.

By deferring collection of standard offer supply costs for five years, and then recovering them through distribution rates, the Settlement would undermine the competitive retail market. As the Department has repeatedly pointed out, for the competitive market to develop, it is essential the price of standard offer and default service reflect the full costs of providing those services. See, e.g., See, e.g., Fitchburg Gas and Electric Light Company, D.T.E. 97-115/98-120 (1999); Western Massachusetts Electric Company, D.T.E. 97-120, (1999); Standard Offer Service Fuel Adjustments, D.T.E. 00-66, 00-67, 00-70, (2000); Pricing and Procurement of Default Service, D.T.E.

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vary from month to month. As a result, the surcharge can be set at a constant level that has a manageable

99-60-A (2000); Provision of Default Service, D.T.E. 02-40-B (2003).

Below-cost standard offer pricing has been a drag on the development of the competitive market since its inception in 1998. Standard offer should not be allowed to end as it began. The final set of standard offer costs should be recovered in energy charges.

C. The Settlement would Violate Principles of Equity and Cost Causation.

By deferring cost recovery of supply costs for five years and then recovering those cost through distribution rates, the Settlement would violate principles of equity and cost causation.

The costs at issue were incurred to serve today's standard offer customers. By shifting the costs from energy to distribution charges, and deferring them for five years, the Settlement would recover those costs from future customers.

It is of course tempting to defer collections in order to provide short-term "rate relief." However, the Department has rejected this course as unwise and inequitable. As the Department said when addressing a much larger problem in connection with the SOSFA deferrals in 2000:

> While any rate increase is unwelcome, we believe the most appropriate course at this time is to institute all actions to provide consumers the least cost over the long term while ensuring equity among all consumers. To accomplish this, it is necessary to stop the accumulation of rapidly growing deferrals with an immediate implementation of the SOSFA to increase the standard offer service rate. ***Equity requires us to ensure that customers on whose behalf costs are incurred are the same customers who bear those costs.***

Standard Offer Service Fuel Adjustments, D.T.E. 00-66, 00-67, 00-70 (emphasis added).

The Department further noted that:

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impact on rates.

> It is not equitable for future customers to pay higher rates in order to allow today's standard offer service customers to pay prices that are significantly below cost. Equity aside, doing so would also be inconsistent with the Act's purpose of an orderly transition to a well-functioning market for electric power. To the greatest extent allowed by the Act, the Department must ensure that prices are set at levels that recover the costs incurred.

Id.

V. DEFERRALS DO NOT CREATE "VALUE" FOR CUSTOMERS.

The Company's filing cover letter asserts that the deferrals create over $51 million in "value" for customers. (Cover Letter p. 2) The basis for this assertion appears to be that interest will be charged only at the customer deposit rate rather than at the Company's cost of capital.

The fact is that the Company proposes to recover these costs from customers with interest. The assertion that the there exist higher interest rates that could be charged does not change this fact. The fallacy of the argument is made clear by considering its logical extension. If a $66 million deferral creates some value, wouldn't a larger deferral create greater value? If so, why stop at $66 million? Why not defer more: $100 million, $200 million, $300 million? Why not defer all electricity costs and leave them for tomorrow's customers to pay?

Rather than creating value, what the Settlement would do is shift costs: from today's customers to tomorrow's customers. Customers as a whole do not realize value. The Department has forcefully rejected such suggestions in the past and should do so again.

If the Department concludes that it is appropriate to defer collection of certain costs, there are other costs that would be more appropriate to defer than standard offer costs. Given that the deferred costs would be collected in wires charges, wires charges should

be deferred. This way, there would be no shifting of costs from supply charges to distribution charges.

VI. THE MASSACHUSETTS ELECTRIC – EASTERN UTILITIES MERGER SETTLEMENT AGREEMENT DOES NOT REQUIRE THE SHIFTING OF SUPPLY COSTS TO DISTRIBUTION RATES.

The current Settlement relies heavily on the Massachusetts Electric – Eastern Utilities merger settlement agreement ("Merger Agreement"), approved by the Department in Docket D.T.E. 99-47. However, there is nothing in the Merger Agreement that requires the cost deferrals proposed in the Settlement. The Merger Agreement addresses the merger of Massachusetts Electric and Eastern Utilities and establishes a multi-year rate plan. The plan limits distribution rate increases for the period through December 2009. (Merger Agreement, § I.C.3)

The Merger Agreement addresses only distribution rates, not supply charges. Nothing in the agreement requires that the standard offer deferrals be collected in distribution rates.

VII. THE MASSACHUSETTS ELECTRIC RESTRUCTURING SETTLEMENT AGREEMENT DOES NOT REQUIRE THE DEFERRALS.

The Massachusetts Electric Restructuring Settlement Agreement, approved by the Department in Docket D.P.U./D.T.E. 96-25 ("Restructuring Settlement"), also does not justify the deferral and transfer of supply costs to distribution rates.[7]

A. The History of the Restructuring Settlement Agreement.

1. The Restructuring Settlement was Written for a Different World.

[7] Curiously, the current proposed Settlement does not cite the Restructuring Settlement as the basis for the deferrals even though the Restructuring Settlement has language addressing the collection of Standard Offer Costs that remain at the end of the Standard Offer period.

The Restructuring Settlement was negotiated in 1996 and approved by the Department in 1997, a time when there were very different expectations about how electric competition would unfold and about what the competitive landscape would look like in 2005.

Most importantly, "default service" did not even exit in the Restructuring Settlement agreement. Default service was created by the Electric Restructuring Act of 1997, St. 1997, c. 164. M.G.L. c. 164, § 1B(d) ("Restructuring Act"), which was enacted more than one year after the Restructuring Settlement was filed with the Department. It was also the Restructuring Act that first provided that standard offer customers would convert to default service at the end of the standard offer period. Id.

By contrast, under the terms of the Restructuring Settlement agreement there was no default service and, indeed, no generally available, utility-provided supply service after the end of the standard offer. There was only "Basic Service," a temporary service for the "***occasional hiatus*** between competitive suppliers." (Restructuring Settlement, § I.B.7) and "Safety Net Service," for low income customers. (Restructuring Settlement, § I.B.6) Accordingly, there was no utility-provided supply service through which the Company could recover any supply cost deferrals that remained at the end of the standard offer. Hence, the only option was to recover those costs through distribution rates.

Today, with the existence of default service, and the mass transfer of 1.5 million standard offer customers to that service, it of course makes sense to recover standard offer deferrals through default service charges. That option was not available at the time of the Restructuring Settlement agreement. Fortunately, it is available today.

Another key difference is that, at the time of the Restructuring Settlement, the expectation was that customers would rapidly migrate to the competitive market, and that

there would be few if any standard offer customers left at the end of the standard offer period. This is clear from the language of the Restructuring Settlement itself. As noted above, the Restructuring Settlement did not create "Default Service" as we know it today. Instead, it created "Basic Service" "[i]n recognition that customers may face an ***occasional hiatus*** between competitive suppliers." Restructuring Settlement, § I.B.7. In practice, now nearly seven years after the market opened, the vast majority of Massachusetts customers have yet to leave standard offer service, and yet to have their ***first*** experience with a competitive supplier, let alone a ***"hiatus"*** between suppliers. The Restructuring Settlement simply did not anticipate that there would be 1.5 million standard offer customers (and 929,000 default service customers) at the end of the Standard Offer period.[8]

Also, at the time that the Restructuring Settlement was negotiated and approved, the Department and the parties greatly underestimated the dampening effect that below cost standard offer prices would have on the development of the competitive market. Indeed, the Department itself pointed this out back in 1999. In ordering Fitchburg Gas and Electric Company to set its retail standard offer prices at its cost, the Department noted that, while it had previously approved settlement agreements (including the Massachusetts Electric agreement) in which retail standard offer prices were below wholesale cost, those approvals were

> issued prior to the retail access date of March 1, 1998. Based on our observation of market activity in Massachusetts and other jurisdictions during the past year, the Department now believes that the transition to a competitive market may be slowed unnecessarily by the divergence of retail and wholesale prices.

[8] According to the DOER Electric Power Customer Migration Data, there were 1,552,993 Standard Offer customers and 929629 default service customers as of October 31, 2004.

Fitchburg Gas and Electric Company, D.T.E. 97-115/98-120 at 28.

2. The Terms of the Restructuring Settlement Agreement have been Changed Numerous Times.

The Restructuring Settlement agreement that was filed with the Department in 1996 has been changed numerous times as conditions have changed and circumstances have warranted.

- The original settlement agreement was filed with the Department on October 1, 1996.
- A revised settlement agreement was filed on January 14, 1997, in response to comments from the Department.
- A second revised agreement was filed on February 13, 1997 in response to comments from members of the Massachusetts State Senate. Portions of this version of the settlement agreement were approved by the Department on February 28, 1997. Massachusetts Electric Company Restructuring Proposal, D.P.U./D.T.E. 96-25 (1997). Other portions were disapproved in May of that year. Massachusetts Electric Company Restructuring Proposal, D.P.U./D.T.E. 96-25 (Phase II) (1997).
- A third revised agreement was filed on May 28, 1997 which reflected changes to the Wholesale Settlement Agreement required by FERC. This version of the agreement was approved by the Department on July 14, 1997. Massachusetts Electric Company Restructuring Proposal, D.P.U./D.T.E. 96-25-A (1997).
- Modifications to the third revised agreement were filed by the Company on December 10, 1997 in response to the Electric Restructuring Act of 1997. St. 1997, c. 164. Some of these modifications were approved by the Department on February 10, 1998. Massachusetts Electric Company Restructuring Proposal, D.P.U./D.T.E. 96-25-C (1998).

Significantly, among the changes that the Company proposed in its December 10, 1997 filing was a change to the manner in which a fuel adjustment credit would be refunded to customers. The Restructuring Settlement provided that final fuel adjustment balances would be collected from or refunded to customers over 3 months. (Restructuring Settlement § I.A.4) But the Company proposed that instead those

balances be refunded over one year because of the size of the credit and the need for rate stability. Massachusetts Electric Company Restructuring Proposal, D.P.U./D.T.E. 96-25-C at 5 and n.6. The Department transferred this issue to a separate proceeding, and ultimately ordered that the balances be refunded over a 6-month period, twice the length of the period provided for in the Restructuring Settlement. Massachusetts Electric Company, 98-13E (1999).

The divergence between the terms of the Restructuring Agreement regarding the fuel adjustment credit and the ultimate disposition of that credit is similar to the instant case: a change in the manner in which funds are collected from or refunded to customers because circumstances have changed and in order to satisfy other important objectives, e.g., rate stability, the development of the competitive market, and equity.[9]

B. The Terms of the Restructuring Settlement Agreement.

The Restructuring Agreement addressed the recovery of standard offer costs that remain at the end of the standard offer period, but also anticipated that its terms would be modified in response to future regulatory change.

Section I.B.5(b) addresses the collection of deferred Standard Offer costs.

> In the event that the revenues billed by Mass. Electric do not recover Mass. Electric's payments to suppliers or Mass. Electric defers expenses to meet the inflation cap established in Section I.B.9, Mass. Electric shall be authorized to accumulate the deficiencies in the account together with interest calculated as above and recover those amounts by implementing a uniform cents per kilowatthour surcharge on the rates for standard offer service, if and to the extent that the access charges billed by Mass. Electric to its retail delivery customers are for any reason below the unadjusted contract termination charges listed under the NEP wholesale rate settlement in Attachment 3. Under-recoveries, if any, that remain after the

[9] The Massachusetts Electric agreement is not the only restructuring settlement agreement that has been changed over the years. In Boston Edison Company, D.T.E. 98-119/126, (1998) (relating to the approval of the Pilgrim Power Plant sale), the Department modified the terms of the Boston Edison restructuring settlement agreement, citing "significant, extraordinary, changed circumstances, the occurrence of which could not have been anticipated at the time the Settlement Agreement was signed."

> standard offer transition period ends on December 31, 2004 shall be recovered from all retail delivery customers by a uniform surcharge not exceeding $0.004 per kilowatthour commencing on January 1, 2010.
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> Section VII.D addresses future regulatory changes:
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> The Department approval of this Settlement shall endure so long as is necessary to fulfill this Settlement's objectives. In the event of future regulatory actions other than actions required by legislative actions taken prior to the Retail Access Date, or legislative actions after the Retail Access Date, which may render any part of this Settlement ineffective, Mass. Electric and NEP shall nevertheless be held harmless and made whole through rates to Mass. Electric's customers.

C. Subsequent Regulatory Actions have Made Section I.B.5(b) of the Restructuring Settlement "Ineffective."

Regulatory actions over the seven years since the approval of the Restructuring Settlement have made § I.B.5(b) "ineffective." Therefore, under § VII.D of the agreement, the Department is free to adjust the mechanism for the recovery of standard offer deferrals, subject only to the requirement that Massachusetts Electric be "held harmless."

The significant regulatory actions since the approval of the settlement include the Department's adoption of a clear regulatory policy that retail standard offer and default service prices "reflect the *full* costs of the service, in order to promote competition," Standard Offer Service Fuel Adjustments, D.T.E. 00-66, 00-67, 00-70, and that "any deferral associated with under-recovery of standard offer costs . . . be recovered as quickly as possible." Western Massachusetts Electric Company, D.T.E. 97-120 (1999) at 191. See also, See, e.g., Fitchburg Gas and Electric Light Company, D.T.E. 97-115/98-120 (1999); Pricing and Procurement of Default Service, D.T.E. 99-60-A (2000); Provision of Default Service, D.T.E. 02-40-B (2003).

The subsequent regulatory changes also include the creation of Congestion, SMD, GIS and RPS costs. These costs, which did not even exist when the Restructuring Settlement was approved, account for $22.6 million of the deferrals. (Settlement, Attachment 3) In the default service context, the Department has ruled that these are supply costs and should be recovered through supply charges. Provision of Default Service, D.T.E. 02-40-B (2003) (congestion costs); Provision of Default Service, D.T.E. 02-40-C at 17 (2003) (RPS costs).

Given that these costs did not exist at the time of the Restructuring Settlement agreement, their collection cannot be governed by the terms of that agreement. Therefore, at a minimum, the Department should remove the $22.6 million in Congestion, SMD, GIS, and RPS costs from the amount being deferred, and require that those costs be collected through supply charges consistent with Department precedent.

VII. THE DEPARTMENT HAS MANY OPTIONS FOR THE RECOVERY OF THE DEFERRED STANDARD OFFER COSTS.

There is no question that the Company is entitled to recover its deferred standard offer supply costs. These costs were incurred to serve customers and should be recovered from those customers.

However, the Department has many options for the recovery of the deferred standard offer costs. Of these, the least desirable is the option put forth in the Settlement: defer recovery of these supply costs for five years and then recover them in distribution rates from customers other than those on whose behalf the costs were incurred.

Given that standard offer customers will convert to default service in just two-and-one- half months, Constellation recommends that the costs be recovered through a surcharge on default service prices. The surcharge should begin on May 1, 2005 and run

for a 12-month period. This approach would keep these supply costs in supply prices and would avoid lengthy deferrals. It would also ensure that the costs are recovered primarily from the customers on whose behalf they were incurred: today's Standard Offer customers. The rate impact of this approach would be approximately 0.42 ¢/kWh..[10, 11]

The May 1, 2005 start date is important because the Company will be receiving bids on Tuesday, December 14, for default service supply for February through April. Given that the bids will be submitted before the Department establishes the surcharge, delaying the implementation of the surcharge until May will preserve the integrity of those bids. Waiting until May will also give adequate notice to customers and enable future wholesale providers of default service to factor the effect of the surcharge into their bids.

VIII. CONCLUSION

For the foregoing reasons, Constellation urges the Department to reject the provisions of the settlement regarding the collection of Standard Offer deferrals and to adopt the recommendations described herein.

[10] The estimated rate impact was calculated by spreading the $66,359,359 deferral over total kWh deliveries to Massachusetts Electric and Nantucket Electric Standard Offer and Default Service customers over the most recent 12-month period reported by the Division of Energy Resources. (DOER Electric Customer Migration Data, November 2004 – October 2004). No adjustments were made for future load growth and customer migration.

[11] If the Department believes that the rate impact would be too great, the Department could defer costs other than supply costs, e.g., stranded cost charges, thereby providing for rate stability while not violating its precedent that standard offer and default services prices must reflect the full cost of providing the service.

Respectfully submitted,

CONSTELLATION NEWENERGY, INC.

By its attorneys,

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Paul W. Gromer
151 Merrimac St., Suite 660
Boston, MA 02114
617-367-0777

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Thomas E. Bessette
Director Regulatory and Government Affairs
Constellation NewEnergy, Inc.
800 Boylston Street, 28th Floor
Boston, MA 02199
(617) 772-7519

CONSTELLATION ENERGY COMMODITIES GROUP, INC.

By

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Daniel Allegretti
Constellation Energy Commodities Group
111 Market Place, Suite 500
Baltimore, MD 21202
410-468-3500

Dated: December 13, 2004